Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board	)	CC Docket No. 96-45
On Universal Service	)	

Comments of Beacon Telecommunications Advisors, LLC

Beacon Telecommunications Advisors, LLC (Beacon) submits these comments in response to the Federal Communications Commission's ("Commission") Notice of Proposed Rulemaking (NPRM) released in the above docketed case on June 8, 2004. The Commission is seeking comment on the *Recommended Decision* of the Federal-State Joint Board on Universal Service ("Joint Board") regarding certain of the Commission's rules relating to high-cost universal service support and the Eligible Telecommunications Carrier (ETC) designation process.[1] Beacon is a regulatory, financial, and management consulting firm providing services to small, rural incumbent local exchange carriers (ILECs) throughout the United States.

Summary of Comments

ETC Designation Process

Beacon recommends that the FCC adopt the specific recommendations proposed by the Joint Board regarding the adoption of permissive minimum federal guidelines for states to consider during their ETC designation process.

Further Development of the Record

First of all, the issues that are contained in this NPRM are important, especially to small, rural ILECs. In order to provide accurate and meaningful comment, a minimum level of

[1] Federal-State Joint Board on Universal Service, Recommended Decision, CC Docket No. 96-45, 19 FCC Rcd 4257 (2004) (*Recommended Decision*)

specificity is required. However, in this NPRM and the underlying *Recommended Decision* the lack of specificity has made it difficult to offer relevant comments on items yet to be developed. This lack of specificity is evidenced by the frequent recommendation from the Joint Board to the FCC to "further develop the record"[2] on many critical and often interrelated issues.

It appears reasonable, if not desired, for "new" options to be presented by commenting parties that procedurally could become rules at the end of this NPRM process. This does not provide sufficient opportunity to analyze and comment on the range of specific options that will be considered by the FCC.

Primary Line Proposal

The Joint Board stated that its overall recommendations were intended to preserve and advance universal service, maintain competitive neutrality, and ensure long-term sustainability of the universal service fund.[3] Regardless of the methodology for disbursing the federal USF dollars, the costs underlying the calculation of these federal USFs for small, rural ILECs are part of their interstate revenue requirement and will remain so regardless of the disbursement method, e.g., primary line.

Based on the examples provided in this filing there is a high probability of an interstate revenue shortfall regardless of the "flavor" of disbursement[4] based on primary line. This would likely result in the unintended consequence of having to raise some other interstate rate to make up for the shortfall. As a result, the FCC should not adopt the primary line disbursement mechanism until such time that these concerns can be adequately addressed.

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[2] In its *Recommended Decision*, the Federal-State Joint Board used the phrase "further develop the record" 10 separate times. For that matter, the FCC in its introductory comments must have recognized the lack of specificity, since it used the same phrase 3 separate times.
[3] *Recommended Decision*, 19 FCC Rcd at 4258, para. 1.
[4] Restatement, lump sum payment, and hold harmless

Comments of Beacon Telecommunications Advisors, LLC

ETC Designation Process

Beacon feels that the minimal qualifications that the Joint Board recommended regarding the ETC designation process are reasonable first steps and should be adopted as permissive federal guidelines. In addition, the recommendation that the FCC encourage state commissions to consider these permissive federal guidelines when evaluating ETC designation requests should also be adopted, again as a first step.

The reasons that these recommendations may only be first steps is that it needs to be seen if these guidelines and encouragement to the states will "promote a predictable application process across states and provide certainty for states in terms of what guidelines may be appropriate to consider in the public interest analysis".

Further Development of the Record

It is difficult, if not impossible to comment on potential rule changes if the options to be analyzed require the record to be developed further and/or require additional comments. Arguably the reason for more information is that there was not a sufficient record to formulate specific changes. It is conceivable, if not likely, that in the process of developing the record further, new proposals will be provided by commenting parties that may be on interest to the Commission. Unfortunately this does not provide parties with a reasonable opportunity to discuss any new specific option developed from the further record that the commission is considering.

While many of the items slated for further record development are details, e.g., implementation, calculation, etc., details are critical in being able to make an informed analysis of a broad proposal. Hopefully an angel will be in the details, but all too often it turns out to be the devil. The unanalyzed detail of implementation may make a proposal that sounded reasonable in theory, total unreasonable in practice.

These issues are important across a wide range of industry participants. Therefore, details are important. Relegating details to further development of the record with no opportunity to comment on them before acceptance of a plan by the FCC is unreasonable.

Primary Line Proposal

In order to fully understand the concerns of Beacon Telecommunications Advisors regarding the primary line proposal, an understanding of interstate revenue requirements, especially those now a part of federal USFs is critical. Therefore a brief history of federal USFs is included below.

History of Federal USFs

Costs or revenue requirements

The reason that this cursory review of history is important is that if the recommended actions – primary line restriction are to have the intended consequences – reduction in FUSF, how these mechanisms work and more importantly how they interact with other mechanisms must be understood. The key is that the costs associated with each of these funds were and are today included as a part of the interstate revenue requirements of regulated local telephone companies, or what is now referred to as ILECs.

Prior to federal price caps, interstate access charges were set based on each ILEC's individual interstate revenue requirements. These interstate revenue requirements were either calculated based on an ILECs specific costs as defined per Federal Communications Commission (FCC) rules contained in Code of Federal Regulations and Regulations Title 47 – Telecommunications, Part 32 (Uniform System of Accounts for Telecommunications Companies), Part 64 Subpart I (Miscellaneous Rules for Common Carriers – Allocation of Costs), Part 36 (Jurisdictional Separations Procedures: Standard Procedures for Separating Telecommunications Property Costs, Revenues, Expenses, Taxes and Reserves for Telecommunications Companies), Part 65 (Interstate Rate of Return Prescription Procedures and Methodologies) and Part 69 (Access Charges) or

were calculated per FCC approved interstate average schedules, depending on whether an ILEC was a cost company or average schedule company.[5]

For rate of return ILECs, their individual interstate revenue requirements are set to recover their legitimate interstate expenses and taxes plus a reasonable return on interstate net investment[6]. Interstate revenues, investment, expenses, reserves and taxes plus the interstate rate of return level are calculated per rules approved by the FCC. These rules are designed to allow the ILEC the opportunity to recover their interstate expenses and taxes plus earn a fair return on their interstate net investment.

In implementing the 1996 Telecommunications Act, the FCC, after consultation with the Joint Board, moved costs already determined to be interstate via the separations process to explicit federal Universal Service Funds. Prior to this, these explicit interstate costs were included in the interstate revenue requirements[7] that were recovered implicitly in interstate access charges per Part 69. For example, revenue requirements associated with the current High Cost Loop Support (HCLS)[8], Long Term Support (LTS)[9], and Interstate Common Line Support (ICLS) were all part of the Carrier Common Line (CCL) access element while the revenue requirements associated with Local Switching Support (LSS) were a part of the Local Switching access element.

The changes to Part 69 and the introduction of Part 54 that moved these interstate revenue requirements from implicit charges to explicit "USF" charges did not change the fact that all of these federal "USF" costs were still interstate revenue requirements. The point is that for rate of return ILECs, the costs associated with all of the current federal

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[5] Starting in January 1, 1998, the rules for calculation of LSS and LTS are contained in Part 54 Universal Service.
[6] Arguably this interstate revenue requirement is still a "floor" even for federal price cap ILECs, but for simplicity's sake, this discussion will concentrate on rate of return ILECs.
[7] In general for this discussion, revenue requirements are costs plus a rate of return on net investment. Technically interstate costs, not revenue requirements, are calculated in Part 36. Part 36 does not calculate either an intrastate or an interstate return component. Part 65 contains the interstate return instructions and the results of Parts 36 and 65 are combined in Part 69 to calculate interstate revenue requirements.
[8] For simplicity's sake, this only applies to the HCLS contained in Part 36 Subpart F Universal Service Fund.
[9] Technically LTS is only available to study areas of rate of return ILECs that have been in the NECA Common Line Pool since January 1, 1998.

USFs were a part of their legitimate interstate revenue requirements before being moved to these USFs and these costs are still a part of their legitimate interstate revenue requirement today. For rate of return ILECs, these funds are not gifts but instead are a part of the total payment for their provisioning of interstate services. If these legitimate revenue requirements are not recovered through the federal USFs that they have been assigned to by the FCC, they must be recovered from some other interstate revenue source.

Revenues

The prior discussion focused on only half of the equation – the costs or revenue requirements. The other side is the distribution or revenue side. In a nutshell, total interstate revenues are intended to recover total interstate revenue requirements. Since each rate of return ILEC have their own unique interstate revenue requirements based on their individual characteristics, the amount of interstate revenues for each of these individual ILECs is designed to match their individual interstate revenue requirements. Therefore, in theory, interstate rates are set so that on a total basis (as opposed to on an individual service basis) so that interstate revenues equal interstate revenue requirements.

There are three major sources of interstate revenues today – interstate access charges, interstate subscriber line charges and disbursements from the federal USFs. Clearly if interstate revenue requirements remain constant, and disbursements from federal USFs decline, then the difference would be need to be made up by another interstate revenue stream, in this case interstate subscriber line charges and/or interstate access charges.[10] If an ILEC is at the cap on intestate SLCs and if interstate access charges are "capped" there is not "residual" revenue stream. In that case, if the FCC chose to address this shortfall on the revenue side, it would have to increase one or more of the existing interstate revenue streams and/or create a new interstate revenue stream. If the FCC chose to address this shortfall on the revenue requirement side, it would have to disallow certain interstate revenue requirements and/or move interstate revenue requirements out of its

[10] The FCC could develop a new charge to recover the shortfall. These are the only two available at present.

regulated jurisdiction by allocating more costs to non regulated or allocating costs to the intrastate jurisdiction[11].

Primary Line Proposal Discussion

The Joint Board recommended that the FCC "limit the scope of high-cost support[12] to a single connection that provides access to the public telephone network" in order to "preserve the sustainability of the universal service fund". Evidently the purpose is to limit the growth in the federal USF dollars or more precisely the size of the disbursements from the federal USFs. However, limiting the distribution to primary lines may reduce the size of the federal USFs, but may, in turn increase some other interstate rate.

For rate of return ILECs all of these "high-cost support" mechanisms have been, are, and will remain as part of an ILEC's interstate revenue requirements. As such, all of these interstate revenue requirements are to be recovered from the revenues/disbursements from interstate services, e.g., interstate access charges, interstate subscriber line charges, and federal USFs. If, as proposed, the disbursements from federal USFs are reduced, either immediately[13] and/or in the future[14], the interstate revenue requirements for rural ILECs as calculated per the current rules may not be completely recovered.

While reductions in the federal USF for ILECs either immediately or in the future may be the stated objective, there may be unintended consequences that would require an increase in the other interstate revenue sources or the implementation of some new interstate revenue source. New and/or increases in established interstate revenue sources

[11] Per convention there are only a limited number of ways to decrease interstate revenue requirements. One way is to perform an audit of Part 32 results and find that the individual ILEC is not following the rules. A second way to decrease interstate revenue requirements is to investigate Part 64 results and find that the individual ILEC's Cost Allocation Manual (CAM) is either not in keeping with FCC rules or not being implemented per its CAM. A third way is to reallocate the interstate costs to the state jurisdiction. This could not be done unilaterally by the FCC and would require action by a separations Federal/State Joint Board. A fourth way to decrease interstate revenue requirements is to disallow the interstate costs of an individual ILEC by finding that these particular costs are not legitimate.
[12] High cost loop support, local switching support, long term support and interstate common line support. These mechanisms will be referred to as federal Universal Service Funds of federal USFs
[13] Restatement and lump sum payment proposals
[14] "Hold harmless" proposal

will be needed because the interstate revenue requirements are not automatically reduced by reductions in the number of dollars received from the federal USF. This will cause total interstate revenues to be less than total interstate revenue requirements.

Rate of return regulation is predicated on the regulated company being able to have an opportunity to recover its legitimate revenue requirements through the revenues derived via rates and other mechanisms prescribed by the regulator. In this case, interstate revenues may be less than interstate revenue requirements, thus not giving the small rural ILEC an opportunity to recover its legitimate interstate revenue requirements.[15] Therefore additional interstate revenues will be needed.

Based on the discussions, or rather the lack of discussions, in both the Joint Board's Recommended Decision and this NPRM, such an outcome if not unintended is at least unanticipated.

For example, in the case of interstate common line/loop, there are two revenue sources to recover the revenue requirement, i.e., interstate SLCs and federal USFs[16]. If the federal USFs are reduced, then clearly the disbursements are likewise reduced, thereby reducing the total interstate revenue stream, unless the shortfall is made up by another interstate revenue source. If a rural ILEC is capped at the maximum interstate SLC rates, the rates, and therefore, the revenues from this revenue stream are also effectively capped. Historically a third revenue stream would have been interstate access charges, but since interstate Carrier Common Line access rates are $0.00, there is interstate revenue from access charges. As shown there is no other interstate revenue stream that is set up to automatically pick up the shortfall. Therefore, in this example, in order to address this interstate revenue shortfall, the FCC would have to increase the SLC cap and/or increase

[15] Recovery of revenue requirements calculated at the authorized rate of return is not necessarily the same as revenue neutrality. Revenue neutrality implies that the revenue level is maintained even if the earned rate of return is higher than the authorized rate of return, thus implying continuation of overearning. The only time revenue neutrality and recovery of revenue requirements are synonymous is if the ILEC is currently earning no more than the authorized rate of return.
[16] Interstate Common Line Support and Long Term Support

the CCL rate. The FCC could also develop a new interstate revenue source. Regardless, the point is that in this example, the Federal USF, in particular ICLS was a residual, just like CCL was in the past. As a result of capping/reducing federal USFs, ICLS can not longer be the residual rate element used to make sure that the total interstate common line revenue requirements are recovered – not more and not less.

The following examples are intended to show first and foremost how the process works and the relationship between revenue requirements and revenue. The examples will show that the FCC has systematically moved interstate revenue requirement to federal USFs. Beacon believes that this does not change either the jurisdiction of the costs or the responsibility of the FCC to ensure that the ILEC has an opportunity to recover these interstate revenue requirements from interstate revenue/disbursement sources. A second objective is to show that the "primary line" proposal put forth by the Federal State Joint Board only addresses the revenue or disbursement side of the equation. There does not appear to be sufficient recognition of the revenue requirement side of the equation and its interaction with the revenue or disbursement side.

Matching of Interstate Revenue Requirements and Interstate Costs Examples

In order to simplify the equation, only loop and local switching will be used. No attempt has been made to reflect timing differences or growth in investment or expenses unless specifically noted. Therefore the costs will remain constant, except in specifically noted examples. Changes will be highlighted in bold.

Pre 1984 – no access charges or end user charges

Prior to 1984 there were no separate, individual revenue streams for the recovery of interstate revenue requirements for local telephone companies. Rather there was a single revenue/disbursement payment to recover all interstate revenue requirements for local telephone companies.[17]

Costs	**Revenues**
$ 700 IS Loop Rev Req	
$ 300 IS Local Switching Rev Req	
$1,000 Total IS Rev Req	$1,000 IS disbursement

Note: IS = Interstate; Rev Req = Revenue Requirements

[17] Interstate rates were set at the authorized interstate rate of return, but were distributed to all local telephone companies using the "achieved" interstate rate of return, at least in theory. Therefore there was not explicit payment for access.

Post 1984 Access charges, end user charges, reduction of interstate loop allocation factor to 25%, additional interstate high cost loop expense adjustment and Long Term Support

On the revenue side, because of the Divestiture of the Bell System, in 1984 "explicit" interstate access charges were developed. In addition, interstate subscriber line charges (SLCs) were started. On the cost side, the interstate loop allocation factor was reduced to 25%. At the same time an additional interstate high cost loop expense adjustment was instituted.[18] In 1989 Long Term Support (LTS) was started and continues today. In order to simplify the example, Transitional Support is not included because it no longer exists.[19]

Costs	**Revenues**
$ 500 IS Loop Rev Req	**$ 150 IS SLCs**
	$ 50 IS LTS
	$ 300 IS CCL Access
$ 200 Additional IS Expense Adj	**$ 200 IS High Cost Loop Fund**
$ 300 IS Local Switching Rev Req	$ 300 IS Local Switching Access
$1,000 Total IS Rev Req	$1,000 Total IS booked revenues

Note: SLC = Subscriber Line Charges; LTS = Long Term Support; CCL = Carrier Common Line

[18] While the overall loop assignment to the interstate jurisdiction was reduced to 25% in order to mitigate the effect on smaller local telephone companies, an additional expense adjustment to the interstate jurisdiction based on a comparison of an individual local telephone company's loop costs as compared to a nationwide average loop cost. This additional expense adjustment was specifically designed to provide a higher additional interstate expense adjustment for smaller local telephone companies. Both of these were phased in together over 8 years.

[19] Transitional Support lasted from 1989 to 1994. See §69.612 for specifics on Long Term Support and Transitional Support.

Current – Introduction of Interstate Common Line Support (ICLS), Carrier Common Line (CCL) = 0, Local Switching Support moved to a federal USF, increase in IS Subscriber Line Charges

In its continued effort to remove subsidies from interstate access charges, the FCC created new revenue streams to offset the decrease in interstate revenues due to the decrease in interstate access rates.[20]

Costs	**Revenues**
$ 500 IS Loop Rev Req	$ **250 IS SLCs**
	$ 50 IS LTS
	$ **0 IS CCL Access**
	$ 200 IS ICLS
$ 200 Additional IS Expense Adj	$ 200 IS High Cost Fund
$ 100 IS Local Switching Rev Req	**$ 100 IS Local Switching Access**
$ 200 DEM weighting Rev Req	**$ 200 IS LSS**
$1,000 Total IS Rev Req	$1,000 Total IS booked revenues

[20] Interstate CCL was reduced to zero in a two step process. ICLS, one of the federal USFs, was designed to replace the revenues no longer provided by interstate CCL. Historically interstate CCL was the residual rate element to insure that the interstate common line (loop) revenue requirement was recovered from the corresponding interstate common line rates. (IS common line revenue requirements – revenues from IS SLCs = IS CCL rev req) The IS CCL rev req was then used to develop the IS CCL rates.

Examples of the Effect of Disbursement of Federal USF Dollars Based on Primary Line Restriction

Potential Effect of Disbursement of High Cost Support based on Primary Line only and ILEC loses 50% of primary lines

As will be shown below, regardless of the "flavor" of the primary line restriction, e.g., restatement, lump sum or hold harmless, there is a strong likelihood that there will be a shortfall of interstate revenues. In other words, legitimate interstate revenue requirements will not be completely recovered, thereby raising the possibility of a confiscation claim.

Based on the lack of comments by either the Joint Board or the FCC regarding even the possibility of this situation arising, Beacon would urge that the FCC not adopt any flavor of primary line restriction until these concerns can be fully addressed.

Restatement Proposal

In order to illustrate how recommendation would work, the ILEC is assumed to lose 50% of the primary lines. A single federal USF total is restated to a primary line basis, e.g., $/primary line. Because a single total federal USF amount is calculated, a 50% reduction in the federal USF amount can be translated into a 50% reduction of the individual federal USFs that make up the single total federal USF. Therefore the total federal USF was initially payable to the ILEC assuming no loss any primary lines was $600 ($200 IS ICLS, $200 IS High Cost Fund, $200 IS LSS). A 50% reduction in the total federal USF disbursement to the ILEC due to the loss of 50% of the primary lines would equate to $300 ($100 IS ICLS, $100 IS High Cost Fund, $100 IS LSS). The interstate revenue requirements/costs do not change, thereby creating a $300 interstate revenue shortfall.

Costs	**Revenues**
$ 500 IS Loop Rev Req	$ 250 IS SLCs
	$ 50 IS LTS
	$ 0 IS CCL Access
	$ 100 IS ICLS
$ 200 Additional IS Expense Adj	**$ 100 IS High Cost Fund**
$ 100 IS Local Switching Rev Req	$ 100 IS Local Switching Access
$ 200 DEM weighting Rev Req	**$ 100 IS Local Switching Support**
$1,000 Total IS Rev Req	$ 700 Total IS booked revenues

Lump Sum Payment

This example assumes that 1/3 of the lines are second lines, thereby reducing the Federal USF's initially by 1/3 ($100 to $67) but introducing a new revenue stream – 2nd line lump sum ($100). In addition, this example assumes that the ILEC has lost ½ of the primary lines to competitors ($67 to $33).

Costs	**Revenues**
$ 500 IS Loop Rev Req	$ 250 IS Subscriber Line Charges
	$ 50 IS Long Term Support
	$ 0 IS Carrier Common Line Access
	$ 33 IS Common Line Support
$ 200 Additional IS Expense Adj	**$ 33 IS High Cost Fund**
$ 100 IS Local Switching Rev Req	$ 100 IS Local Switching Access
$ 200 DEM weighting Rev Req	**$ 33 IS Local Switching Support**
	$ 100 IS 2nd line lump sum
$1,000 Total IS Rev Req	$ 600 Total IS booked revenues

Hold Harmless

Base case

In keeping with the previous examples, there is no change in the interstate revenue requirements. As shown the "hold harmless" does not change the amount that the ILEC receives, regardless of number of primary lines retained or lost..

Costs	**Revenues**
$ 500 IS Loop Rev Req	$ 250 IS Subscriber Line Charges
	$ 50 IS Long Term Support
	$ 0 IS Carrier Common Line Access
	$ 200 IS Common Line Support
$ 200 Additional IS Expense Adj	$ 200 IS High Cost Fund
$ 100 IS Local Switching Rev Req	$ 100 IS Local Switching Access
$ 200 DEM weighting Rev Req	$ 200 IS Local Switching Support
$1,000 Total IS Rev Req	$1,000 Total IS booked revenues

Hold Harmless #2

Hold harmless is less effective in a non-static environment, e.g., network upgrade. In this example, the interstate revenue requirements increased due to the additional costs associated with the network upgrade. However, in this example, there is no increase in the number of primary lines.

Costs	**Revenues**
$ 700 IS Loop Rev Req	$ 250 IS Subscriber Line Charges
	$ 50 IS Long Term Support
	$ 0 IS Carrier Common Line Access
	$ 200 IS Common Line Support
$ 300 Additional IS Expense Adj	$ 200 IS High Cost Fund
$ 100 IS Local Switching Rev Req	$ 100 IS Local Switching Access
$ 200 DEM weighting Rev Req	$ 200 IS Local Switching Support
$1,300 Total IS Rev Req	$1,000 Total IS booked revenues

Conclusions

Additional ETC Designation

Beacon endorses that the additional ETC designation criteria recommended by the Joint Board be adopted by the FCC.

Further Development of the Record

Beacon is concerned about the lack of specificity regarding the alternatives to be addressed in this proceeding. It is not clear that if the record needs to be further developed that a reasonable opportunity has been given to the parties to provide the necessary analysis and comment in this NPRM cycle.

Primary Line Proposal

First of all, nowhere in the recommended decision is there a definition of "primary line". At first glance, it may appear obvious, but such glances can be deceiving. It is doubtful that one line per structure is reasonable.

In addition, in all but the hold harmless #1, there is a shortfall regarding the interstate revenue covering the interstate revenue requirements. In every other example, there would need to be an increase in interstate revenues to cover the interstate revenue requirements in order to avoid a possible confiscation claim.

The reason that this is important is that per convention, there would need to be an additional interstate revenue stream in order to make up the difference. Today the only interstate revenue streams are interstate access, interstate SLCs, and federal USFs. Therefore while the objective may have been to stabilize/reduce the federal USFs, based on the options recommended in this NPRM, there could be the unintended consequence of having to raise some other interstate rate to make up for any reduction in ILEC federal USF disbursements.

Because of the lack of specificity on such basic issues as the definition of primary line coupled with a high probability of an interstate revenue shortfall and the resulting unintended consequence of having to raise some other interstate rate to make up for the shortfall, the FCC should not adopt any flavor or the primary line disbursement mechanism.

Respectfully submitted,

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[Filed Electronically]

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